

**Cheltenham & Gloucester plc
Annual Report and Accounts 2011**

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**Member of Lloyds Banking Group
(Formerly Lloyds TSB Group)**

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DIRECTORS' REPORT

The Directors have pleasure in presenting their report for Cheltenham & Gloucester plc for the year ended 31 December 2011

Principal activities

The principal activities of Cheltenham & Gloucester plc (the "Company") are the arranging and administering of mortgage and savings accounts on behalf of Lloyds TSB Bank plc (the "Bank"), the immediate parent company

The Company's subsidiaries are dormant with the exception of C&G Property Holdings Limited whose principal activity is that of property leasing to the Company

The Company and its subsidiaries are referred to in these financial statements as "C&G" or the "Group"

Results and dividends

The consolidated profit on ordinary activities before tax for the year ended 31 December 2011 is £102.0 million (2010: £94.3 million)

Dividends of £50 million (2010: £50 million) were paid during the year

Business review and future developments

The Company's primary objectives are to ensure that mortgages and savings accounts are sold and maintained properly and efficiently and the Company continues to focus on providing quality service to these account holders of the Bank

The Company operates to service standards that have been agreed with the Bank, and is reimbursed for these services by the Bank. The Company remains well placed to continue to sell and administer mortgage and savings accounts for the Bank at the current high quality levels

The Company's performance is measured by the Bank using a number of key performance indicators which are monitored and reviewed by the Bank on an on-going basis and are disclosed in the financial statements of Lloyds Banking Group

Directors

The Directors of the Company who served during the year were as follows

AB Lenman
SJ Noakes (Appointed 30 September 2011)

MJ Kula (Resigned 30 March 2011)
C Walsh (Resigned 30 September 2011)

The Company Secretaries who served during the year were A Wakes (nee Lockwood) (resigned 25 November 2011) and P Gittins (appointed 25 November 2011)

DIRECTORS' REPORT (Continued)

Policy and practice on payment of suppliers

The Company follows "The Better Payment Practice Code" published by the Department for Business Innovation and Skills (BIS) regarding the making of payments to suppliers. A copy of the code and information about it may be obtained from the BIS Publications Order Line 0845 0150 010 quoting ref URN 04/606

The Company's policy is to agree terms of payment with suppliers and these normally provide for settlement within 30 days after the date of the invoice, except where other arrangements have been negotiated. It is the policy of the Company to abide by the agreed terms of payment, provided the supplier performs according to the terms of the contract. The creditor days for 2011 are 22 (2010 11)

Financial risk management

The consideration of risks and uncertainties of the business such as interest rate risk, foreign currency risk, credit risk and liquidity risk are set out in note 23 to the financial statements. There are no areas of concern that carry significant risks of causing material adjustments to the carrying value of the Company's assets and liabilities.

Auditors and disclosure of information to auditors

Each Director in office at the date of this report confirms that

- so far as the Director is aware, there is no relevant audit information of which the Company's auditors are unaware, and
- the Director has taken all the steps that he ought to have taken as a Director in order to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information

This confirmation is given, and should be interpreted, in accordance with the provisions of section 418 of the Companies Act 2006

PricewaterhouseCoopers LLP have indicated their willingness to continue in office and a resolution re-appointing them as auditors and authorising the Directors to set their remuneration will be proposed at the annual general meeting

Employees

C&G and Lloyds Banking Group believe that diversity helps differentiate us from our competitors. We are committed to providing employment practices and policies which recognise the diversity of our workforce and ensure equality of opportunity for employees regardless of sex, race, disability, age, sexual orientation or religious belief. In the event of members of staff becoming disabled, every effort is made to ensure that their employment with Lloyds Banking Group continues and the appropriate training is arranged.

We monitor progress on diversity annually and put in place programmes to improve the career experience of diverse groups. We believe that a committed workforce that reflects the diversity of our customers will have a positive impact on our results.

In the UK, Lloyds Banking Group belongs to employer groups including Employers' Forum on Disability, Employers' Forum on Age, Stonewall and the Race for Opportunity. Our involvement with these organisations enables us to identify and implement best practice for our staff.

Lloyds Banking Group operates a number of employee share schemes details of which are set out in note 20.

Employees are kept closely involved in major changes affecting them through such measures as team meetings, briefings, internal communications and opinion surveys. There are well established procedures, including regular meetings with recognised unions, to ensure that the views of employees are taken into account in reaching decisions.

Lloyds Banking Group is committed to providing employees with comprehensive coverage of the economic and financial issues affecting the Group. We have established a full suite of communication channels, including an extensive face-to-face briefing programme which allows us to update our employees on our performance and any financial issues throughout the year.

DIRECTORS' REPORT (Continued)

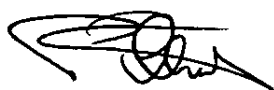
Directors' indemnities

The Company has made qualifying third party indemnity provisions for the benefit of the directors. These indemnity provisions remain in force at the date of this report. The deed is available for inspection at the registered office of Lloyds Banking Group plc.

Statement On Going Concern

The company is reliant on fee income from Lloyds TSB Bank plc. Owing to uncertainty in financial markets, Lloyds Banking Group plc and Lloyds TSB Bank plc participate in government sponsored measures to improve funding and liquidity. The directors are satisfied that it is the intention of Lloyds TSB Bank plc that the Company will continue to receive fee income in the future and, accordingly, the financial statements have been prepared on a going concern basis.

On behalf of the Board



P Gittins
Company Secretary

28th March 2012

DIRECTORS' RESPONSIBILITIES STATEMENT

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the group and parent company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the group and the company and of the profit or loss of the group for that period. In preparing these financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgements and accounting estimates that are reasonable and prudent,
- state whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the company and the group and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and the group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF CHELTENHAM & GLOUCESTER PLC

We have audited the Group and Parent company financial statements (the "financial statements") of Cheltenham & Gloucester plc for the year ended 31 December 2011 which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Group and Parent Company Balance Sheets, the Group and Parent Company Statements of Changes in Equity, the Group and Parent Company Cash Flow Statements and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the Parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 4, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the Group's and Parent Company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors, and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report and Accounts to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2011 and of the group's profit and group's and parent company's cash flows for the year then ended,
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union,
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006, and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

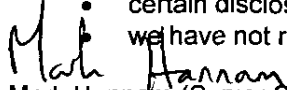
In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us, or
- the parent company financial statements are not in agreement with the accounting records and returns, or

• certain disclosures of directors' remuneration specified by law are not made, or
we have not received all the information and explanations we require for our audit


Mark Hannam (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Leeds, United Kingdom
28 March 2012

**CONSOLIDATED INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2011**

	Note	2011 £m	2010 £m
Interest expense		-	(0 1)
Net interest expense		-	(0 1)
Fee and commission income		435 6	430 5
Fee and commission expense		-	(0 1)
Net fee and commission income		435 6	430 4
Other income		435 6	430 4
Total net income		435 6	430 3
Operating expenses	2	(333 6)	(336 0)
Profit before tax	3	102 0	94 3
Taxation	4	(30 1)	(4 9)
Profit for the financial year attributable to shareholders	5	71 9	89 4

All of the above activities relate to continuing operations

**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2011**

	2011 £m	2010 £m
Profit for the year	71 9	89 4
Total comprehensive income for the year	71 9	89 4

The accompanying notes on pages 11 to 32 are an integral part of the financial statements

BALANCE SHEETS
AT 31 DECEMBER 2011

	Note	Group 2011 £m	Group 2010 £m	Company 2011 £m	Company 2010 £m
Current assets					
Loans and advances to banks	6	195 6	169 3	195 6	169 3
Due from Group Companies	7	197 1	197 7	201 0	202 0
Other assets		3 6	2 2	3 5	2 0
Total current assets		<u>396 3</u>	<u>369 2</u>	<u>400 1</u>	<u>373 3</u>
Non-current assets					
Tangible fixed assets	8	37 3	42 0	28 7	32 9
Deferred tax asset	11	8 4	14 3	8 8	14 7
Shares in subsidiaries	12	-	-	1 3	1 3
Total non-current assets		<u>45 7</u>	<u>56 3</u>	<u>38 8</u>	<u>48 9</u>
Total assets		<u>442 0</u>	<u>425 5</u>	<u>438 9</u>	<u>422 2</u>
Equity and liabilities					
Current liabilities					
Current tax liabilities		24 2	18 1	24 0	17 7
Owed to Group Companies	13	123 3	128 4	123 1	128 4
Other liabilities	14	49 1	37 5	49 4	37 5
Provisions	15	-	1 6	-	1 6
Total current liabilities		<u>196 6</u>	<u>185 6</u>	<u>196 5</u>	<u>185 2</u>
Non-current liabilities					
Other borrowed funds	17	5 0	5 0	5 0	5 0
Retirement benefit obligations	16	51 3	67 7	51 3	67 7
Total non-current liabilities		<u>56 3</u>	<u>72 7</u>	<u>56 3</u>	<u>72 7</u>
Total liabilities		<u>252 9</u>	<u>258 3</u>	<u>252 8</u>	<u>257 9</u>
Equity					
Share capital	18	70 0	70 0	70 0	70 0
Retained profits		119 1	97 2	116 1	94 3
Shareholder's equity		<u>189 1</u>	<u>167 2</u>	<u>186 1</u>	<u>164 3</u>
Total equity and liabilities		<u>442 0</u>	<u>425 5</u>	<u>438 9</u>	<u>422 2</u>

The accompanying notes on pages 11 to 32 are an integral part of the financial statements

The Directors approved the financial statements on 28 March 2012

28th March 2012

AB Lenman Director



**STATEMENTS OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2011**

	Note	Share capital and premium £m	Retained profits £m	Total £m
Group				
Balance sheet at 1 January 2011		70 0	97 2	167 2
Profit for the year		-	71 9	71 9
Dividends	19	-	(50 0)	(50 0)
Balance at 31 December 2011		<u>70 0</u>	<u>119 1</u>	<u>189 1</u>
Company				
Balance sheet at 1 January 2011		70 0	94 3	164 3
Profit for the year	5	-	71 8	71 8
Dividends	19	-	(50 0)	(50 0)
Balance at 31 December 2011		<u>70 0</u>	<u>116 1</u>	<u>186 1</u>
Group				
Balance sheet at 1 January 2010		70 0	57 8	127 8
Profit for the year		-	89 4	89 4
Dividends	19	-	(50 0)	(50 0)
Balance at 31 December 2010		<u>70 0</u>	<u>97 2</u>	<u>167 2</u>
Company				
Balance sheet at 1 January 2010		70 0	55 7	125 7
Profit for the year	5	-	88 6	88 6
Dividends	19	-	(50 0)	(50 0)
Balance at 31 December 2010		<u>70 0</u>	<u>94 3</u>	<u>164 3</u>

The accompanying notes on pages 11 to 32 are an integral part of the financial statements

**CASH FLOW STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2011**

	Note	Group 2011 £m	Group 2010 £m	Company 2011 £m	Company 2010 £m
Profit before tax		102.0	94.3	101.8	93.7
Adjusted for					
Depreciation & impairment of PPE	8	3.2	3.5	2.7	3.3
Loss on disposal of fixed assets		0.9	-	0.9	-
Income tax paid		(18.1)	(1.5)	(17.7)	(1.7)
		<u>88.0</u>	<u>96.3</u>	<u>87.7</u>	<u>95.3</u>
Changes in operating assets and liabilities					
Decrease in debtors		(0.8)	124.8	(0.5)	125.9
Increase in creditors		6.5	(36.2)	6.5	(36.3)
Decrease in provisions		(1.6)	(3.3)	(1.6)	(3.3)
Reduction in retirement obligations		(16.4)	(23.4)	(16.4)	(23.4)
Net cash provided by operating activities		<u>75.7</u>	<u>158.2</u>	<u>75.7</u>	<u>158.2</u>
Cash flows from investing activities					
Purchase of fixed assets		(2.1)	(0.3)	(2.1)	(0.3)
Proceeds from sale of fixed assets		2.7	-	2.7	-
Net cash provided by/(used in) investing activities		<u>0.6</u>	<u>(0.3)</u>	<u>0.6</u>	<u>(0.3)</u>
Cash flows from financing activities					
Dividends paid		(50.0)	(50.0)	(50.0)	(50.0)
Net cash used in financing activities		<u>(50.0)</u>	<u>(50.0)</u>	<u>(50.0)</u>	<u>(50.0)</u>
Change in cash and cash equivalents		26.3	107.9	26.3	107.9
Cash and cash equivalents at beginning of year		169.3	61.4	169.3	61.4
Cash and cash equivalents at end of year	6	<u>195.6</u>	<u>169.3</u>	<u>195.6</u>	<u>169.3</u>

The accompanying notes on pages 11 to 32 are an integral part of the financial statements

NOTES TO THE FINANCIAL STATEMENTS

1. ACCOUNTING POLICIES

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU) and the Companies Act 2006, applicable to companies reporting under IFRS. IFRS comprises accounting standards prefixed IFRS issued by the International Accounting Standards Board (IASB) and those prefixed IAS issued by the IASB's predecessor body as well as interpretations issued by the IFRS Interpretations Committee (IFRIC) and its predecessor bodies. The EU-endorsed version of IAS 39 'Financial Instruments: Recognition and Measurement' relaxes some of the hedge accounting requirements, this is not relevant to the Group and therefore there is no difference in application to the Group between IFRS as adopted by the EU and IFRS as issued by the IASB. The Group is incorporated and domiciled in England and Wales.

Details of those IFRS pronouncements which will be relevant to the Group but which were not effective at 31 December 2011 and which have not been applied in preparing these financial statements are given in note 24.

The financial information has been prepared under the historical cost convention as modified by the revaluation of land and buildings.

The Group's accounting policies are set out below.

Consolidation

The assets, liabilities and results of Group undertakings (subsidiaries) are included in the financial statements on the basis of accounts made up to the reporting date.

Subsidiaries

Subsidiaries include entities over which the Group has the power to govern the financial and operating policies which generally accompanies a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group; they are de-consolidated from the date that control ceases. Details of the principal subsidiaries are given in note 12.

Intercompany transactions, balances and unrealised gains and losses on transactions between Group companies are eliminated.

Revenue recognition

Fees and commissions are generally recognised when the service has been provided, the income arises from the administration of mortgage and savings on behalf of Lloyds TSB Bank plc.

Interest income and expense are recognised in the income statement for all interest-bearing financial instruments using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense over the expected life of the financial instrument. The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability.

The effective interest rate is calculated on initial recognition of the financial asset or liability, estimating the future cash flows after considering all the contractual terms of the instrument but not future credit losses. The calculation includes all amounts expected to be paid or received by the Company including expected early redemption fees and related penalties and premiums and discounts that are an integral part of the overall return. Direct incremental transaction costs related to the acquisition, issue or disposal of a financial instrument are also taken into account in the calculation. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Loans and receivables

Loans and receivables include loans and advances to banks and customers and eligible loans and receivables are initially recognised when cash is advanced to the borrowers at fair value inclusive of transaction costs or, for eligible assets transferred into this category, their fair value at the date of transfer. Loans and receivables are initially

1.ACCOUNTING POLICIES (continued)

recognised at fair value and subsequently held at amortised cost

Borrowings

Borrowings are recognised initially at fair value, being their issue proceeds net of transaction costs incurred. These instruments are subsequently stated at amortised cost using the effective interest method.

Preference shares and other instruments which carry a mandatory coupon or are redeemable on a specific date are classified as financial liabilities. The coupon on these instruments is recognised in the income statement as interest expense.

Tangible fixed assets

Tangible fixed assets are included at cost less accumulated depreciation. The value of land (included in premises) is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate the difference between the cost and the residual value over their estimated useful lives, as follows:

Premises (excluding land)

- Freehold / long and short leasehold premises: shorter of 50 years or the remaining period of the lease
- Leasehold improvements: shorter of 10 years or, if lease renewal is not likely, the remaining period of the lease

Equipment

- Fixtures and furnishings: 10-20 years
- Other equipment: 3-8 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. In the event that an asset's carrying amount is determined to be greater than its recoverable amount, it is written down immediately. The recoverable amount is the higher of the asset's fair value less costs to sell and its value in use.

Leases

The leases entered into by the Group are primarily operating leases. Operating lease rentals payable are charged to the income statement on a straight-line basis over the period of the lease.

When an operating lease is terminated before the end of the lease period, any payment made to the lessor by way of penalty is recognised as an expense in the period of termination.

Pensions and other post-retirement benefits

The Company's immediate parent company operates a number of post-retirement benefit schemes for its employees, including the employees of the Company, including both defined benefit and defined contribution pension plans. A defined benefit scheme is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, dependent on one or more factors such as age, years of service and salary. A defined contribution plan is a pension plan into which the Group pays fixed contributions; there is no legal or constructive obligation to pay further contributions.

Full actuarial valuations of the principal defined benefit schemes are carried out every three years with interim reviews in the intervening years; these valuations are updated to 31 December each year by qualified independent actuaries. For the purposes of these annual updates, scheme assets are included at their fair value and scheme liabilities are measured on an actuarial basis using the projected unit credit method, adjusted for unrecognised actuarial gains and losses. The defined benefit scheme liabilities are discounted using rates equivalent to the market yields at the balance sheet date on high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability.

The Group's income statement charge includes the current service cost of providing pension benefits, the expected return on the schemes' assets, net of expected administration costs, and the interest cost on the schemes' liabilities. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are not recognised unless the cumulative unrecognised gain or loss at the end of the previous reporting period exceeds

1.ACCOUNTING POLICIES (continued)

the greater of 10 per cent of the scheme assets or liabilities ('the corridor approach') In these circumstances the excess is charged or credited to the income statement over the employees' expected average remaining working lives Past service costs are charged immediately to the income statement, unless the charges are conditional on the employees remaining in service for a specified period of time (the vesting period) In this case, the past service costs are amortised on a straight-line basis over the vesting period

The Group's balance sheet includes the net surplus or deficit, being the difference between the fair value of scheme assets and the discounted value of scheme liabilities at the balance sheet date adjusted for any cumulative unrecognised actuarial gains or losses Surpluses are only recognised to the extent that they are recoverable through reduced contributions in the future or through refunds from the schemes

The Group recognises the effect of material changes to the terms of its defined benefit pension plans which reduce future benefits as curtailments, gains and losses are recognised in the income statement when the curtailments occur

The costs of the Group's defined contribution plans are charged to the income statement in the period in which they fall due

Share-based compensation

The Company's ultimate parent company operates a number of equity-settled, share-based compensation plans in respect of services received from certain of its employees including those employed by the Company The value of the employee services received in exchange for equity instruments granted under these plans is recognised as an expense over the vesting period of the instruments, with a corresponding increase in equity This expense is determined by reference to the fair value of the number of equity instruments that are expected to vest The fair value of equity instruments granted is based on market prices, if available, at the date of grant In the absence of market prices, the fair value of the instruments at the date of grant is estimated using an appropriate valuation technique, such as a Black-Scholes option pricing model The determination of fair values excludes the impact of any non-market vesting conditions, which are included in the assumptions used to estimate the number of options that are expected to vest At each balance sheet date, this estimate is reassessed and if necessary revised Any revision of the original estimate is recognised in the income statement over the remaining vesting period, together with a corresponding adjustment to equity Cancellations by employees of contributions to the Group's Save As You Earn plans are treated as non-vesting conditions and in accordance with the revised IFRS 2 the Group recognises, in the year of cancellation, the amount of the expense that would have otherwise been recognised over the remainder of the vesting period Modifications are assessed at the date of modification and any incremental charges are charged to the income statement over any remaining vesting period

Taxation

Current income tax which is payable on taxable profits is recognised as an expense in the period in which the profits arise

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements However, deferred tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss Deferred tax is determined using tax rates that have been enacted or substantively enacted by the balance sheet date which are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled

Deferred tax assets are recognised where it is probable that future taxable profit will be available against which the temporary differences can be utilised Deferred tax is provided on temporary differences arising from investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the difference will not reverse in the foreseeable future Income tax payable on profits is recognised as an expense in the period in which those profits arise The tax effects of losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised

Deferred and current tax assets and liabilities are offset when they arise in the same tax reporting group and where there is both a legal right of offset and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously

Provisions

Provisions are recognised in respect of present obligations arising from past events where it is probable that

1.ACCOUNTING POLICIES (continued)

outflows of resources will be required to settle the obligations and they can be reliably estimated

The Group recognises provisions in respect of vacant leasehold property where the unavoidable costs of the present obligations exceed anticipated rental income

Contingent liabilities are possible obligations whose existence depends on the outcome of uncertain future events or those present obligations where the outflows of resources are uncertain or cannot be measured reliably. Contingent liabilities are not recognised in the financial statements but are disclosed unless they are remote

Dividends

Dividends paid on the Group's ordinary shares are recognised as a reduction in equity in the period in which they are paid

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise cash and non-mandatory balances with central banks and amounts due from banks with a maturity of less than three months

Critical accounting estimates and judgements

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts of assets, liabilities, income and expenses. Due to the inherent uncertainty in making estimates, actual results reported in future periods may be based upon amounts which differ from those estimates. Estimates, judgements and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

The Group makes judgements and estimates in the preparation of the results and financial position however none of these are deemed to be critical

2. OPERATING EXPENSES

	Note	2011 £m	2010 £m
Salaries and profit sharing		63.8	65.6
Social security costs		4.7	4.5
Pension costs	16		
Defined benefit scheme		1.9	(4.5)
Defined contribution scheme		2.2	2.2
Staff costs		<u>72.6</u>	<u>67.8</u>
Other administrative expenses		261.0	268.2
		<u>333.6</u>	<u>336.0</u>

The average number of persons employed by the Group and the Company during the year was as follows

	Group 2011	Group 2010	Company 2011	Company 2010
UK	<u>1,844</u>	<u>1,779</u>	<u>1,844</u>	<u>1,779</u>
	<u>1,844</u>	<u>1,779</u>	<u>1,844</u>	<u>1,779</u>

2 OPERATING EXPENSES (continued)

Auditors' remuneration:

	2011 £'000	2010 £'000
Fees payable to the Company's Auditor for the audit of the Company's annual accounts	20	20
Fees payable to the Company's Auditor and its associates for other services		
- The audit of the Company's subsidiaries, pursuant to legislation	2	2
- All other services	-	-

It is the Group's policy to use the auditors on assignments in cases where their knowledge of the Group means that it is neither efficient nor cost effective to employ another firm of accountants. Such assignments typically relate to the provision of advice on tax issues, assistance in transactions involving the acquisition and disposal of businesses, and accounting advice.

The Group has procedures to ensure that fees for audit and non-audit services are approved in advance.

3. PROFIT BEFORE TAX

Profit before tax is stated after taking account of

	2011 £m	2010 £m
Loss on disposal of premises & equipment	0.9	-
Depreciation	2.8	-
Impairment loss	0.4	-
Operating lease rental charges paid	11.8	12.4

4 TAXATION

(a) Analysis of charge in period:

	Note	2011 £m	2010 £m
UK corporation tax			
Current tax on profits for the year		24.2	-
Corporation tax charge		24.2	-
Deferred tax	11		
Current year		4.1	5.0
Prior year		1.8	(0.1)
Total tax charge		30.1	4.9

The standard corporation tax rate for the year changed from 28% to 26% with effect from 1 April 2011.

(b) Factors affecting tax charge for the period

A reconciliation of the total tax charge for the year to the charge that would result from applying the standard UK corporation tax rate to profit before tax is given below.

2011 £m	2010 £m
------------	------------

Tax charge at UK corporation tax rate of 26.5% (2010 28%)	27.1	26.4
Non-allowable items	0.8	0.6
Effect of reduction in deferred tax rate to 25%	0.8	0.5
Group relief received for no payment	-	(22.0)
Deferred tax on business combination	-	(0.1)
IFRS 2 Deferred tax release	(0.4)	(0.4)
Adjustment to tax charge in respect of prior years	1.8	(0.1)
Total tax charge	30.1	4.9

With effect from 1 April 2012, the main rate of corporation tax will be reduced from 26% to 25%. This results in a reduction in the Group's deferred tax asset at 31 December 2011 of approximately £846k. The proposed further reductions in the rate of corporation tax by 1% per annum to 23% by 1 April 2014 are expected to continue to be enacted separately each year. The effect of these further changes upon the Group's deferred tax balances is not quantifiable at this time.

5. PROFIT FOR THE FINANCIAL YEAR ATTRIBUTABLE TO SHAREHOLDERS

The profit attributable to shareholders includes a profit of £71.8 million (2010 £88.6 million) dealt with in the financial statements of the parent company, for which no income statement is presented as permitted of section 408 of the Companies Act 2006.

6. LOANS AND ADVANCES TO BANKS

	Group 2011 £m	Group 2010 £m	Company 2011 £m	Company 2010 £m
Loans and advances to banks	<u>195.6</u>	<u>169.3</u>	<u>195.6</u>	<u>169.3</u>
Included above				
Due from Lloyds Banking Group subsidiary Undertakings				
All unsubordinated	<u>195.6</u>	<u>169.3</u>	<u>195.6</u>	<u>169.3</u>

At 31 December 2011, £nil (2010 £nil) of loans and advances to banks of the Group and Company had a contractual residual maturity of greater than one year.

7. DUE FROM GROUP COMPANIES

	Group 2011 £m	Group 2010 £m	Company 2011 £m	Company 2010 £m
Due from Lloyds Banking Group subsidiary undertakings				
All unsubordinated	<u>197.1</u>	<u>197.7</u>	<u>201.0</u>	<u>202.0</u>

At 31 December 2011, £nil (2010 £nil) of intercompany debtors had a contractual residual maturity of greater than one year.

8. TANGIBLE FIXED ASSETS

	Group Premises £m	Group Equipment £m	Group Total £m	Company Premises £m	Company Equipment £m	Company Total £m
Cost						
At 1 January 2010	59.3	45.9	105.2	47.4	45.9	93.3
Additions	-	0.3	0.3	-	0.3	0.3
Disposals	-	(0.1)	(0.1)	-	(0.1)	(0.1)
At 31 December 2010	59.3	46.1	105.4	47.4	46.1	93.5
Additions	2.1	-	2.1	2.1	-	2.1
Disposals	(2.1)	(38.7)	(40.8)	(2.1)	(38.7)	(40.8)
At 31 December 2011	59.3	7.4	66.7	47.4	7.4	54.8
Depreciation						
At 1 January 2010	20.2	39.8	60.0	17.7	39.7	57.4
Charge for the year	1.6	1.9	3.5	1.4	1.9	3.3
Disposals	-	(0.1)	(0.1)	-	(0.1)	(0.1)
At 31 December 2010	21.8	41.6	63.4	19.1	41.5	60.6
Charge for the year	1.9	0.9	2.8	1.8	0.9	2.7
Impairment loss	0.4	-	0.4	-	-	-
Disposals	(0.5)	(36.7)	(37.2)	(0.5)	(36.7)	(37.2)
At 31 December 2011	23.6	5.8	29.4	20.4	5.7	26.1
Net book value						
31 December 2011	35.7	1.6	37.3	27.0	1.7	28.7
31 December 2010	37.5	4.5	42.0	28.3	4.6	32.9

	Group 2011 £m	Group 2010 £m	Company 2011 £m	Company 2010 £m
Net book value of premises comprises				
Freeholds	24.9	26.6	16.0	17.4
Leaseholds 50 years and over unexpired	6.4	7.2	6.4	7.2
Leaseholds less than 50 years unexpired	0.9	1.1	0.9	1.1
Adaptation costs	3.5	2.6	3.7	2.6
	35.7	37.5	27.0	28.3

9 OPERATING LEASE COMMITMENTS

At the balance sheet date, the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows

	Group 2011 £m	Group 2010 £m	Company 2011 £m	Company 2010 £m
Not later than 1 year	11.9	11.8	12.7	12.6
Later than 1 year and not later than 5 years	42.1	40.3	45.4	43.6
Later than 5 years	39.2	42.8	60.4	64.8
	93.2	94.9	118.5	121.0

10 CAPITAL COMMITMENTS

Capital expenditure contracted, but not provided for, at 31 December 2011 amounted to nil for the Group and the Company (2010 Group and Company nil)

11 DEFERRED TAX ASSET

	Group 2011 £m	Group 2010 £m	Company 2011 £m	Company 2010 £m
At 1 January	14.3	19.2	14.7	19.6
Income statement debit	(5.9)	(4.9)	(5.9)	(4.9)
At 31 December	<u>8.4</u>	<u>14.3</u>	<u>8.8</u>	<u>14.7</u>
Of which				
Within 1 year	4.0	5.9	4.0	5.9
More than 1 year	4.4	8.4	4.8	8.8
	<u>8.4</u>	<u>14.3</u>	<u>8.8</u>	<u>14.7</u>

The deferred tax charge in the income statement comprised the following temporary differences

	Group 2011 £m	Group 2010 £m	Company 2011 £m	Company 2010 £m
Accelerated depreciation allowances	0.3	0.4	0.3	0.4
Retirement benefit obligations	(5.5)	(8.0)	(5.5)	(8.0)
Other provisions				
Other temporary differences	(0.7)	2.7	(0.7)	2.7
Total movement in deferred tax	<u>(5.9)</u>	<u>(4.9)</u>	<u>(5.9)</u>	<u>(4.9)</u>

The net deferred tax asset is comprised as follows

	Group 2011 £m	Group 2010 £m	Company 2011 £m	Company 2010 £m
Deferred tax assets				
Retirement benefit obligations	12.8	18.3	12.8	18.3
Deferred tax liabilities				
Accelerated capital allowances	(1.2)	(1.5)	(1.2)	(1.0)
Other temporary differences	(3.2)	(2.5)	(2.8)	(2.6)
	<u>(4.4)</u>	<u>(4.0)</u>	<u>(4.0)</u>	<u>(3.6)</u>
	<u>8.4</u>	<u>14.3</u>	<u>8.8</u>	<u>14.7</u>

12. SHARES IN SUBSIDIARIES

	Company 2011	2010
	£m	£m
Cost		
At 1 January and 31 December	<u>1 3</u>	<u>1 3</u>

The principal Group undertakings, all of which prepare financial statements to 31 December and whose results are included in the consolidated financial statements of Cheltenham & Gloucester plc, are

	Country of registration / incorporation	Nature of business	Ownership
C&G Property Holdings Limited	England and Wales	Property holding and leasing	100%
C&G Estate Agents Limited	England and Wales	Dormant	100%
C&G Financial Services Limited	England and Wales	Dormant	100%
C&G Homes Limited	England and Wales	Dormant	100%
Central Mortgage Finance Limited	England and Wales	Dormant	100%
Lloyds TSB Mortgages Limited	England and Wales	Dormant	100%

13 OWED TO GROUP COMPANIES

	Group 2011 £m	Group 2010 £m	Company 2011 £m	Company 2010 £m
Due to Lloyds Banking Group subsidiary undertakings	<u>123 3</u>	<u>128 4</u>	<u>123 1</u>	<u>128 4</u>

At 31 December 2011, £nil (2010 £nil) of intercompany creditors had a contractual residual maturity of greater than one year

14. OTHER LIABILITIES

	Group 2011 £m	Group 2010 £m	Company 2011 £m	Company 2010 £m
Accruals and deferred income	32 8	22 5	32 8	22 5
Other liabilities	16 3	15 0	16 6	15 0
	<u>49 1</u>	<u>37 5</u>	<u>49 4</u>	<u>37 5</u>

15. PROVISIONS

	Group 2011 £m	Group 2010 £m	Company 2011 £m	Company 2010 £m
At 1 January	1 6	4 9	1 6	4 9
Additional provision in the year	-	1 6	-	1 6
Utilisation of provision	(1 6)	(4 9)	(1 6)	(4 9)
At 31 December	-	1 6	-	1 6
Current	-	1 6	-	1 6
Non current	-	-	-	-
Total provision charge	-	1 6	-	1 6

Provisions are made for staff and other costs related to Group restructuring initiatives at the point at which the Group becomes irrevocably committed to the expenditure

16 RETIREMENT BENEFIT OBLIGATIONS

Defined contribution schemes

The Company's ultimate parent company operates a number of defined contribution pension schemes, principally the defined contribution sections of the Lloyds TSB Group Pension Schemes No's 1 and 2, new employees are offered membership of the defined contribution section of the Lloyds TSB Group Pension Scheme No 1

Defined benefit schemes

The Company's ultimate parent company has established a number of defined benefit pension schemes in the UK and overseas. The majority of the Company's employees are members of the defined benefit sections of the Lloyds TSB Group Pension Schemes No's 1 and 2. These are funded schemes providing retirement benefits calculated as a percentage of final salary depending upon the length of service, the minimum retirement age under the rules of the schemes is 50.

The latest full valuations of the two main schemes were carried out as at 30 June 2008, these have been updated to 31 December 2011 by qualified independent actuaries.

The amounts shown below relate to the Company's share of obligations arising from membership by the Company's employees of the defined benefit schemes operated by the Company's ultimate parent company.

Amount included in the balance sheet

	2011 £m	2010 £m
Company's share of present value of funded obligations	1,085 2	1,060 0
Company's share of fair value of scheme assets	(968 8)	(935 1)
	116 4	124 9
Company's share of unrecognised actuarial losses	(65 1)	(57 2)
Liability in the balance sheet	51 3	67 7

The movements in the liability recognised in the balance sheet are as follows

	2011 £m	2010 £m
At 1 January	67 7	91 1
Net charge to the income statement	1 9	(4 5)
Contributions paid	(18 3)	(18 9)
At 31 December	51 3	67 7

16. RETIREMENT BENEFIT OBLIGATIONS (Continued)

The expense recognised in the income statement comprises

	2011 £m	2010 £m
Current service cost	4 5	7 8
Interest cost	25 5	43 4
Expected return on scheme assets	(28 1)	(44 5)
Curtailment	-	(14 5)
Amortisation outside corridor	-	3 3
	<u>1 9</u>	<u>(4 5)</u>

The following information relates to Lloyds TSB Group Pension Schemes No's 1 and 2 as at 31 December 2011.

In accordance with IAS 19, the remaining information below relates to the No's 1 and 2 schemes operated by the Company's ultimate parent company and amounts are shown in £ millions unless otherwise stated

The Company's ultimate parent company expects to pay contributions of approximately £183 million in respect of the No's 1 and 2 schemes in 2012

Movements in the defined benefit obligation

	2011 £m	2010 £m
At 1 January	16,627	16,962
Merger of No 1 and AMC schemes	-	31
Current service cost	166	175
Interest cost	897	931
Actuarial gains	236	(278)
Benefits paid	(604)	(622)
Past service cost	10	19
Curtailment	-	(591)
At 31 December	<u>17,332</u>	<u>16,627</u>

Changes in the fair value of scheme assets

	2011 £m	2010 £m
At 1 January	16,290	14,662
Merger of No 1 and AMC schemes	-	30
Expected return	1,009	952
Employer contributions	413	216
Actuarial gains/(losses)	146	1,052
Benefits paid	(604)	(622)
At 31 December	<u>17,254</u>	<u>16,290</u>
Actual return on scheme assets	<u>1,155</u>	<u>2,004</u>

16 RETIREMENT BENEFIT OBLIGATIONS (Continued)

The principal actuarial and financial assumptions used in valuations of the pension schemes were as follows

	2011 %	2010 %
Discount rate	5.00	5.50
Rate of inflation		
Retail Prices Index	3.00	3.40
Consumer Price Index	2.00	2.90
Rate of salary increases	2.00	2.00
Rate of increase for pensions in payment and deferred pensions	2.80	3.20
	Years	Years
Life expectancy for member aged 60, on the valuation date		
- Men	27.3	27.2
- Women	28.4	28.3
Life expectancy for member aged 60, 15 years after the valuation date		
- Men	28.8	28.2
- Women	30	29.9

The mortality assumptions used in the scheme valuations are based on standard tables published by the Institute and Faculty of Actuaries which were adjusted in line with both current industry experience and the actual experience of the relevant schemes

An analysis of the impact of a reasonable change in these assumptions is provided in the 2011 annual report and financial statements of the Company's ultimate parent company (note 23)

The expected return on scheme assets for the No 1 and 2 pension schemes is based on the following assumptions

	2011 %	2010 %
Equities	8.3	8.3
Fixed interest gilts	4.0	4.5
Index linked gilts	3.9	4.1
Non-government bonds	4.9	6.0
Property	7.3	7.5
Cash	3.9	4.3

The expected return on scheme assets in 2011 for the No 1 and 2 pension schemes will be calculated using the following assumptions

	2012 %
Equities	7.3
Fixed interest gilts	3.0
Index linked gilts	2.8
Non-government bonds	4.9
Property	6.6
Cash	2.6

16. RETIREMENT BENEFIT OBLIGATIONS (Continued)

Composition of scheme assets

	2011 £m	2010 £m
Equities	6,495	7,481
UK fixed interest gilts	391	540
UK index linked gilts	4,692	3,188
Sterling non-government bonds	2,882	2,248
Property	1,311	1,323
Derivative assets	642	837
Cash, and other assets and liabilities	841	673
At 31 December	<u>17,254</u>	<u>16,290</u>

The assets of all the funded plans are held independently of the Lloyds Banking Group's assets in separate trustee administered funds

The expected return on plan assets was determined by considering the expected returns available on the assets underlying the current investment policy. Expected yields on fixed interest investments are based on gross redemption yields at the balance sheet date. Expected returns on equity and property investments reflect long-term real rates of return experienced in the respective markets.

Experience adjustments history (since the date of adoption of IAS 19)

	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Present value of defined benefit obligation	17,332	16,627	16,962	14,089	15,303
Fair value of scheme assets	<u>(17,254)</u>	<u>(16,290)</u>	<u>(14,662)</u>	<u>(12,433)</u>	<u>(14,746)</u>
	78	337	2,300	1,656	557
Unrecognised actuarial gains/(losses)	<u>(769)</u>	<u>(679)</u>	<u>(2,146)</u>	<u>(217)</u>	<u>1,234</u>
(Asset)/Liability in the balance sheet	<u>(691)</u>	<u>(342)</u>	<u>154</u>	<u>1,439</u>	<u>1,791</u>
Experience losses on scheme liabilities	<u>(132)</u>	<u>(396)</u>	<u>(3)</u>	<u>(29)</u>	<u>(180)</u>
Experience gains/(losses) on scheme assets	<u>146</u>	<u>1,052</u>	<u>440</u>	<u>(3,227)</u>	<u>147</u>

The expense recognised in the ultimate parent company's income statement comprises

	2011 £m	2010 £m
Current service cost	166	175
Interest cost	897	931
Expected return on scheme assets	(1,009)	(952)
Past service cost	10	19
Amortisation outside corridor	-	48
Immediate recognition of curtailment	-	89
Curtailment	-	(591)
Total pension expense	<u>64</u>	<u>(281)</u>

17. OTHER BORROWED FUNDS

	2011 £m	2010 £m
Preference shares	<u>5 0</u>	<u>5 0</u>
	2011 Number (m) and £m	2010 Number (m) and £m
Authorised		
Preference shares of £1 each	10	10
'B' preference shares of £1 each	10	10
Issued and fully paid		
Preference shares of £1 each	3 8	3 8
'B' preference shares of £1 each	1 2	1 2

The terms of the preference shares require the Company to pay a non-cumulative dividend at the rate of LIBOR plus 75 basis points per cent per annum on the amount for the time being paid up on each preference share. This is paid annually on 30 June. Other borrowed funds are all classed as non-current.

18 CALLED UP SHARE CAPITAL

	2011 Number in millions	2010 Number in millions	2011 £m	2010 £m
Authorised ordinary shares of £1 each At 1 January and 31 December	<u>311 7</u>	<u>311 7</u>	<u>311 7</u>	<u>311 7</u>
Issued and fully paid ordinary shares of £1 each At 1 January and 31 December	<u>70 0</u>	<u>70 0</u>	<u>70 0</u>	<u>70 0</u>

The company has one class of ordinary voting shares which carry no right to fixed income.

19. ORDINARY DIVIDENDS

The dividends paid in the year were as follows

	2011 £m	2010 £m
Final dividend in respect of preceding year At 31 December	<u>50 0</u> <u>50 0</u>	<u>50 0</u> <u>50 0</u>
Dividend per share	<u>71 4p</u>	<u>71 4p</u>

20. SHARE BASED PAYMENTS

Share-based payments

During the year ended 31 December 2011, the Company's ultimate parent company operated the following share-based payment schemes, all of which are equity settled

Executive schemes

The executive share option schemes were long-term incentive schemes available to certain senior executives of the Lloyds Banking Group, with grants usually made annually. Options were granted within limits set by the rules of the schemes relating to the number of shares under option and the price payable on the exercise of options. The last grant of executive options was made in August 2005. These options were granted without a performance multiplier and the maximum limit for the grant of options in normal circumstances was three times annual salary. Between April 2001 and August 2004, the aggregate value of the award based upon the market price at the date of grant could not exceed four times the executive's annual remuneration and, normally, the limit for the grant of options to an executive in any one year would be equal to 1.5 times annual salary with a maximum performance multiplier of 3.5. Prior to 18 April 2001, the normal limit was equal to one year's remuneration and no performance multiplier was applied.

Performance conditions for executive options

For options granted up to March 2001

The performance condition was that growth in earnings per share must be equal to the aggregate percentage change in the Retail Price Index plus three percentage points for each complete year of the relevant period together with a further condition that Lloyds Banking Group plc's ranking based on total shareholder return (calculated by reference to both dividends and growth in share price) over the relevant period should be in the top fifty companies of the FTSE 100.

The relevant period for the performance conditions began at the end of the financial year preceding the date of grant and continued until the end of the third subsequent year following commencement or, if not met, the end of

20. SHARE BASED PAYMENTS (continued)

such later year in which the conditions were met. Once the conditions were satisfied the options remain exercisable without further conditions. If they were not satisfied by the tenth anniversary of the grant the options would lapse.

For options granted from August 2001 to August 2004

The performance condition was linked to the performance of Lloyds Banking Group plc's total shareholder return (calculated by reference to both dividends and growth in share price) against a comparator group of 17 companies including Lloyds Banking Group plc.

The performance condition was measured over a three year period which commenced at the end of the financial year preceding the grant of the option and continued until the end of the third subsequent year. If the performance condition was not then met, it was measured at the end of the fourth financial year. If the condition was not then met, the options would lapse.

To meet the performance conditions, the Lloyds Banking Group plc's ranking against the comparator group required to be at least ninth. The full grant of options only became exercisable if Lloyds Banking Group plc was ranked first. A performance multiplier (of between nil and 100 per cent) was applied below this level to calculate the number of shares in respect of which options granted to Executive Directors would become exercisable, and were calculated on a sliding scale. If Lloyds Banking Group plc was ranked below median the options would not be exercisable.

Options granted to senior executives other than Executive Directors were not so highly leveraged and, as a result, different performance multipliers were applied to their options. For the majority of executives, options were granted with the performance condition but with no performance multiplier.

For options granted in 2005

The same conditions applied as for grants made up to August 2004, except that

20. SHARE BASED PAYMENTS (continued)

- the performance condition was linked to the performance of Lloyds Banking Group plc's total shareholder return (calculated by reference to both dividends and growth in share price) against a comparator group of 15 companies including Lloyds Banking Group plc,
- if the performance condition was not met at the end of the third subsequent year, the options would lapse, and
- the full grant of options became exercisable only if Lloyds Banking Group plc was ranked in the top four places of the comparator group. A sliding scale applied between fourth and eighth positions. If Lloyds Banking Group plc was ranked below the median (ninth or below) the options would lapse.

Save-As-You-Earn schemes

Eligible employees may enter into contracts through the Save-As-You-Earn schemes to save up to £250 per month and, at the expiry of a fixed term of three, five or seven years, have the option to use these savings within six months of the expiry of the fixed term to acquire shares in Lloyds Banking Group plc at a discounted price of no less than 80 per cent of the market price at the start of the invitation.

Other share option plans

Lloyds TSB Group Executive Share Plan 2003

The plan was adopted in December 2003 and under the plan share options may be granted to senior employees. Options under this plan have been granted specifically to facilitate recruitment and as such were not subject to any performance conditions. The plan's usage has now been extended to not only compensate new recruits for any lost share awards but also to make grants to key individuals for retention purposes with, in some instances, the grant being made subject to individual performance conditions.

Other share plans

Long-Term Incentive Plan

The Long-Term Incentive Plan (LTIP) introduced in 2006 is aimed at delivering shareholder value by linking the receipt of shares to an improvement in the performance of the Lloyds Banking Group over a three year period. Awards are made within limits set by the rules of the plan, with the limits determining the maximum number of shares that can be awarded equating to three times annual salary. In exceptional circumstances this may increase to four times annual salary.

The performance conditions for awards made in March and August 2007 are as follows:

- For 50 per cent of the award (the EPS Award) – the percentage increase in earnings per share of Lloyds Banking Group plc (on a compound annualised basis) over the relevant period needed to be at least an average of 6 percentage points per annum greater than the percentage increase (if any) in the Retail Price Index over the same period. If it was less than 3 per cent per annum the EPS Award would lapse. If the increase was more than 3 per cent but less than 6 per cent per annum then the proportion of shares released would be on a straight line basis between 17.5 per cent and 100 per cent. The relevant period commenced on 1 January 2007 and ended on 31 December 2009.
- For the other 50 per cent of the award (the TSR Award) – it was necessary for Lloyds Banking Group plc's total shareholder return (calculated by reference to both dividends and growth in share price) to exceed the median of a comparator group (14 companies) over the relevant period by an average of 7.5 per cent per annum for the TSR Award to vest in full. 17.5 per cent of the TSR Award would vest where Lloyds Banking Group plc's total shareholder return was equal to median and vesting would occur on a straight line basis in between these points. Where Lloyds Banking Group plc's total shareholder return was below the median of the comparator group, the TSR Award would lapse. The relevant period commenced on 8 March 2007 and ended on 7 March 2010.

As a consequence of the acquisition of HBOS and the general market turmoil, in March 2009 the Remuneration Committee decided that the performance test for the 2007 awards should be based on the performance of Lloyds Banking Group plc up to 17 September 2008, the date prior to the announcement of the HBOS acquisition. The performance test was on a fair value basis, on the estimated probability, as at that date, of achieving the performance conditions.

20. SHARE BASED PAYMENTS (continued)

The performance conditions for awards made in March, April and August 2008 are as follows

- (i) For 50 per cent of the award (the EPS Award) – the performance condition is as described for the 2007 awards with the relevant performance period commencing on 1 January 2008 and ending on 31 December 2010
- (ii) For the other 50 per cent of the award (the TSR Award) – the performance condition is as described for the 2007 awards, except that the comparator group comprises of 13 companies, with the relevant performance period commencing on 6 March 2008 (the date of the first award) and ending on 5 March 2011

The current LTIP rules allow for awards to be made of up to 400 per cent of base salary. Under normal circumstances awards are made of 300 per cent of salary with the additional 100 per cent available for circumstances that the Remuneration Committee deems to be exceptional. In 2008, awards were made of 375 per cent of base salary to the chief executive and two of the Executive Directors for retention purposes, and in light of data reviewed by the committee which showed total remuneration to be behind median both for the FTSE 20, and the other major UK banks.

As for the 2007 LTIP awards, as a consequence of the acquisition of HBOS and the general market turmoil, in March 2009 the Remuneration Committee decided that the performance test for the 2008 awards should be based on the performance of Lloyds Banking Group plc up to 17 September 2008, the date prior to the announcement of the HBOS acquisition. The performance test was on a fair value basis, on the estimated probability, as at that date, of achieving the performance conditions.

The performance conditions for awards made in April, May and September 2009 are as follows

EPS relevant to 50 per cent of the award Performance will be measured on the extent to which the growth in EPS achieves cumulative EPS targets over the three-year period.

Economic Profit relevant to 50 per cent of the award Performance will be measured based on the extent to which cumulative Economic Profit targets are achieved over the three-year period.

An additional discretionary award was made in April, May and September 2009. The performance conditions for those awards are as follows

Synergy savings The release of 50 per cent of the shares will be dependent on the achievement of target run-rate synergy savings in 2009 and 2010 as well as the achievement of sustainable synergy savings of at least £1.5 billion by the end of 2011. The award will be broken down into three equally weighted annual tranches. Performance will be assessed at the end of each year against annual performance targets based on a trajectory to meet the 2011 target. The extent to which targets have been achieved will determine the proportion of shares to be banked each year. Any release of shares will be subject to the Remuneration Committee judging the overall success of the delivery of the integration programme.

Integration balanced scorecard The release of the remaining 50 per cent of the shares will be dependent on the outcome of a Balanced Scorecard of non-financial measures of the success of the integration in each of 2009, 2010 and 2011. The Balanced scorecard element will be broken down into three equally weighted tranches. The tranches will be crystallised and banked for each year of the performance cycle subject to separate annual performance targets across the four measurement categories of Building the Business, Customer, Risk and People and Organisation Development.

The performance conditions for awards made in March and August 2010 are as follows

EPS relevant to 50 per cent of the award Performance will be measured based on absolute improvement in adjusted EPS over the three financial years starting on 1 January 2010 relative to an adjusted fully diluted 2010 EPS base.

Economic Profit relevant to 50 per cent of the award Performance will be measured based on the compound annual growth rate of adjusted Economic Profit over the three financial years starting on 1 January 2010 relative to an adjusted 2009 Economic Profit base.

20. SHARE BASED PAYMENTS (continued)

Performance share plan

Under the performance share plan, introduced during 2005, participating executives would have been eligible for an award of free shares, known as performance shares, to match the bonus shares awarded as part of their 2004 and 2005 bonus. The maximum match was two performance shares for each bonus share, awarded at the end of a three year period. The actual number of shares which would have been awarded was dependent on Lloyds Banking Group plc's total shareholder return performance measured over a three year period, compared to other companies in the comparator group. The maximum of two performance shares for each bonus share would have been awarded only if Lloyds Banking Group plc's total shareholder return performance placed it first in the comparator group, one performance share for each bonus share would have been granted if Lloyds Banking Group plc was placed fifth, and one performance share for every two bonus shares if Lloyds Banking Group plc was placed eighth (median). Between first and fifth position, and fifth and eighth position, sliding scales would have applied. If the total shareholder return performance was below median, no performance shares would have been awarded. There was no retest. Whilst income tax and national insurance was deducted from the bonus before deferral into the plan, where a match of performance shares was justified, these shares would have been awarded as if income tax and national insurance had not been deducted.

Share incentive plan

Free shares

An award of shares may be made annually to employees based on a percentage of each employee's salary in the preceding year up to a maximum of £3,000. The percentage is normally announced concurrently with Lloyds Banking Group plc's annual results and the price of the shares awarded is announced at the time of award. The shares awarded are held in trust for a mandatory period of three years on the employee's behalf, during which period the employee is entitled to any dividends paid on such shares. The award is subject to a non-market based condition: if an employee leaves the Lloyds Banking Group within this three year period for other than a 'good' reason, all of the shares awarded will be forfeited.

No free shares were awarded in 2010 or 2011.

20. SHARE BASED PAYMENTS (continued)

Matching shares

Lloyds Banking Group plc undertakes to match shares purchased by employees up to the value of £30 per month, these shares are held in trust for a mandatory period of three years on the employees' behalf, during which period the employee is entitled to any dividends paid on such shares. The award is subject to a non-market based condition: if an employee leaves within this three year period for other than a 'good' reason, 100 per cent of the matching shares are forfeited. Similarly if the employees sell their purchased shares within three years, their matching shares are forfeited.

The number of shares awarded relating to matching shares in 2011 was 30,999,387 (2010: 17,411,651), with an average fair value of £0.42 (2010: £0.63), based on market prices at the date of award.

Other information

The charge made to the income statement represents the Company's share of the cost of the above schemes. This charge has been allocated to the Company based on the number of the Company's employees who participate in the above schemes. It is not practicable for the Company to provide information regarding the ranges of exercise prices, weighted average exercise prices, weighted average remaining contractual life information and the number of options outstanding that is specific to the Company's employees without incurring significant additional cost.

Full details of the ranges of exercise prices, weighted average exercise prices, weighted average remaining contractual life information and number of options outstanding for the above schemes overall can be found in the 2011 annual report and accounts of the Company's ultimate parent company. Copies of the ultimate parent company's 2011 annual report and accounts may be obtained from the Company Secretary's Department, Lloyds Banking Group plc, 25 Gresham Street, London, EC2V 7HN.

21. DIRECTORS' EMOLUMENTS

The Directors are employed by other companies in the Lloyds Banking Group and consider that their services to the company are incidental to their other activities within the Group and therefore their emoluments have not been disclosed

22. RELATED PARTY TRANSACTIONS

There are a number of transactions with Lloyds Banking Group plc and its subsidiary companies Where applicable the transactions have been disclosed in the notes to the financial statements

The following table details the impact of transactions with Lloyds Banking Group companies through the income statement

	2011 £m	2010 £m
Preference share interest expense	0.1	0.1
Commission receivable	423.5	425.5
Administrative expenses	215.2	242.5

The Company leases a property from its subsidiary C&G Property Holdings Limited for which it paid rental charges of £0.8m during the year (2010 £0.8m) In addition, the Company receives interest on a loan outstanding from the subsidiary which was £0.0m for the year (2010 £0.0m) The principal amount of the loan outstanding at 31 December 2011 was £4.0m (2010 £4.4m)

In addition, there are amounts due to the Company from its dormant subsidiary companies which have been written off in these consolidated financial statements as the amounts are not deemed to be recoverable, given the dormant nature of the entities The amounts which have been included in the subsidiary company financial statements but have previously been written off by C&G are C&G Estate Agents Limited of £1.9m, C&G Homes Limited of £13.6m, and Central Mortgage Finance Limited of £4.3m

The Group's related parties also include key management personnel Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Group, which for the Group is the board of Directors of C&G

A number of banking transactions were entered into with key management in the normal course of business These included loans and deposits The Directors of C&G who hold C&G products ceased to have a related party relationship in relation to these mortgages and savings balances on transfer of the balances to the Bank in 2007

23. FINANCIAL RISK MANAGEMENT POLICIES

The Directors are responsible for establishing a framework for evaluating, measuring, monitoring and controlling risk. They are responsible for ensuring that the risks within the business are identified, assessed, monitored and controlled. These controls and procedures where relevant comply with Lloyds Banking Group policies and standards.

Interest Rate Risk

The Company has no interest-bearing assets from third parties and no deposits are placed outside of the Lloyds Banking Group. Assets due from Lloyds Banking Group Companies are subject to variable interest rates. Interest is received on a loan from a subsidiary company at the Bank of England base rate. As such, this represents exposure to fluctuations in interest rates. If interest rates for the year ended 31 December 2011 had been 150 basis points higher with all other variables held constant, post-tax profits for the year would have been £52.5k (2010 £52k) higher, as a result of increased interest income on the Company's loan from the subsidiary company.

Currency Risk

The Company holds no foreign currency assets or liabilities and transacts all business in GBP and therefore has no significant exposure to currency risks.

Credit Risk

The majority of income received by the Company is from Lloyds Banking Group companies. Hence, as there is no direct third party income, credit risk is capable of close monitoring and control. All loans and advances are neither past due nor impaired.

Liquidity risk

The Group is deemed to have low exposure to the risk of being unable to meet its financial obligations as they fall due or only being able to do so at an unacceptably high cost. This is because the Group is funded by companies within Lloyds Banking Group plc and, as a result, liquidity risk is managed within the Lloyds Banking Group.

The table below analyses liabilities of the Group on an undiscounted future cash flows basis according to contractual maturity into relevant maturity groupings based on the remaining period at the balance sheet date. Balances with no fixed maturity are included in the over 5 years category.

As at 31 December 2011	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Liabilities						
Current tax	-	-	24.2	-	-	24.2
Owed to Group Companies	123.3	-	-	-	-	123.3
Other liabilities	49.1	-	-	5.0	51.3	105.4
Provisions	-	-	-	-	-	-
Total	172.4	-	24.2	5.0	51.3	252.9

23. FINANCIAL RISK MANAGEMENT POLICIES (continued)

As at 31 December 2010	Up to 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m	Total £m
Liabilities						
Current tax	-	-	18 1	-	-	18 1
Owed to Group Companies	128 4	-	-	-	-	128 4
Other liabilities	37 5	-	-	5 0	67 7	110 2
Provisions	-	-	1 6	-	-	1 6
Total	165 9	-	19 7	5 0	67 7	258 3

Capital

The managed capital of the Company constitutes total shareholder's funds. These consist entirely of issued ordinary share capital and retained profit and loss.

The Company is authorised and regulated by the Financial Services Authority ('FSA') and is subject to the FSA's capital resource requirements per the FSA IPRU(Invt) and MIPRU Rulebooks. Capital is actively managed at an appropriate level of frequency and regulatory capital levels are a key factor in the Group's budgeting and planning processes. All FSA capital requirements imposed on the Company during the year were met.

24 FUTURE ACCOUNTING DEVELOPMENTS

The following pronouncements may have a significant effect on the Group's financial statements but are not applicable for the year ending 31 December 2011 and have not been applied in preparing these financial statements. The full impact of these accounting changes is being assessed by the Group.

Pronouncement	Nature of change	IASB effective date
IFRS 9 Financial Instruments ¹	Replaces those parts of IAS 39 <i>Financial Instruments Recognition and Measurement</i> relating to the classification, measurement and derecognition of financial assets and liabilities. Requires financial assets to be classified into two measurement categories, fair value and amortised cost, on the basis of the objectives of the entity's business model for managing its financial assets and the contractual cash flow characteristics of the instrument. The available-for-sale financial asset and held-to-maturity investment categories in existing IAS 39 will be eliminated. The requirements for financial liabilities and derecognition are broadly unchanged from IAS 39.	Annual periods beginning on or after 1 January 2015
IFRS 10 Consolidated Financial Statements	Supersedes IAS 27 <i>Consolidated and Separate Financial Statements</i> and SIC-12 <i>Consolidation – Special Purpose Entities</i> and establishes principles for the preparation of consolidated financial statements when an entity controls one or more entities.	Annual periods beginning on or after 1 January 2013
IFRS 12 <i>Disclosure of Interests in Other Entities</i>	Requires an entity to disclose information that enables users of financial statements to evaluate the nature of, and risks associated with, its interests in other entities and the effects of those interests on its financial position, financial performance and cash flows.	Annual periods beginning on or after 1 January 2013
IFRS 13 <i>Fair Value Measurement</i>	The standard defines fair value, sets out a framework for measuring fair value and requires disclosures about fair value measurements. It applies to IFRSs that require or permit fair value measurements or disclosures about fair value measurements.	Annual periods beginning on or after 1 January 2013

IAS 19 <i>Employee Benefits</i>	Prescribes the accounting and disclosure by employers for employee benefits Actuarial gains and losses (remeasurements) in respect of defined benefit pension schemes are no longer deferred using the corridor approach and are recognised immediately in other comprehensive income	Annual periods beginning on or after 1 January 2013
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¹¹ IFRS 9 is the initial stage of the project to replace IAS 39 Future stages are expected to result in amendments to IFRS 9 to deal with changes to the impairment of financial assets measured at amortised cost and hedge accounting Until all stages of the replacement project are complete, it is not possible to determine the overall impact on the financial statements of the replacement of IAS 39

At the date of this report, these pronouncements are awaiting EU endorsement

25. GUARANTEES

Under the Building Societies Act 1986, Cheltenham & Gloucester Building Society had an obligation to discharge the liabilities of its subsidiary companies in so far as they were unable to discharge the liabilities out of their own assets Under the Building Societies (Transfer of Business) Regulations 1988, any obligations which existed at 31 July 1995 remain as obligations of Cheltenham & Gloucester plc

26. PARENT COMPANIES

The Company's immediate parent company is Lloyds TSB Bank plc The company regarded by the Directors as the ultimate parent company is Lloyds Banking Group plc, a limited liability company incorporated and domiciled in Scotland, which is also the parent undertaking of the largest group of undertakings for which group accounts are drawn up and of which the Company is a member The Bank is the parent undertaking of the smallest such group of undertakings Copies of the group accounts of both companies may be obtained from Group Secretariat, Lloyds Banking Group plc, 25 Gresham Street, London EC2V 7HN

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